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Guatemala: Struggling To Set a New Economic Course

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An Intelligence Assessment

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July 1983

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Guatemala: Struggling To Set a New Economic Course [redacted]

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An Intelligence Assessment

This assessment was prepared by [redacted] of the Office of African and Latin American Analysis, with a contribution by Albert Gordon, Office of Central Reference. It was coordinated with the Directorate of Operations and the National Intelligence Council. Comments and queries are welcome and may be addressed to the Chief, Middle America–Caribbean Division, ALA, on [redacted]

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Guatemala: Struggling To Set a New Economic Course [redacted] 25X1

Key Judgments

Information available as of 20 June 1983 was used in this report.

The Guatemalan economy—Central America's largest—contracted last year for the first time in several decades. Even though the military government installed following the coup on 23 March 1982 made considerable headway in fighting insurgents and opening the political system, it was unable to fully offset a variety of economic problems. Internal turmoil and mismanagement by the previous government had hampered efforts to get the economy on track following a set of external shocks in 1979. Continuing low world prices for key crops, the further shrinkage of the important Central American market for manufactures exports, and the dearth of international credit precipitated an acute foreign exchange shortage. The results were a sharp cut in imports that hit construction activity, manufacturing, and commercial agriculture hardest, and a boost in the unemployment rate to over 20 percent. [redacted] 25X1

Recognizing that Guatemala's ability to control the insurgency and garner foreign exchange will shape business confidence and drive economic performance over the near term, we analyzed the impact of these factors under three scenarios for political and security conditions. If, as we expect, President Efrain Rios Montt retains power through 1984 but only contains the insurgency, Guatemala will require new foreign aid totaling $440-545 million in 1983 and roughly $575-680 million in 1984 merely to shore up imports sufficiently to prevent per capita incomes from falling. [redacted] 25X1

Regardless of which scenario we examined, the same basic limitations stand out to constrain economic activity through 1984 at least:

- Even if the global economic recovery is stronger than generally expected, the spectacular rise in commodity prices needed to remedy Guatemala's foreign exchange bind is unlikely.
- The depressed regional economy is likely to preclude a resurgence in exports of Guatemala's manufactured goods.
- Under the best of circumstances, tourism would be slow to revive from the bad publicity ensuing from regional turmoil.
- Businessmen probably will remain chary of sizable investments even if security continues to improve.
- Any steps toward more cohesive economic policies are likely to be limited and to have little immediate impact largely because of the government's lack of will. [redacted] 25X1

Because foreign funds are unlikely to reach our targeted levels and the government is unlikely to eradicate the insurgency, we believe the economy will shrink about 4 percent this year and, perhaps, stabilize in 1984. Even if the insurgency could be eliminated, the demand for foreign financial support would remain high. Import needs would continue to be large as farm owners and businessmen began to replace wornout capital stock and replenish input inventories. On the other hand, any escalation of the insurgency could wipe out remaining business confidence and renew the flight of capital and talent. In this case, Guatemala would require enormous foreign aid to combat the guerrillas, to meet emergency needs, and to restart the economy. 25X1

We judge that Guatemala will be unable to restore any time in the 1980s the high growth rates of the 1970s. Even a modest recovery would require the continued success of the government in providing moderate, reform-oriented leadership. We believe this task, in turn, will become more difficult as opposition activities grow in the next few years in reaction to the expected regrouping of the insurgents, the pickup in political and labor union activity associated with recent reforms, and the prolongation of the economic recession. Moreover, a spirit of cooperation between the public and private sectors will be needed to attract and manage the unprecedented sums of foreign aid that will be critical to sustain recovery. Because some elements in the military want to push social programs more than businessmen do, frictions between these groups over reforms are likely to spill over and make national economic management more contentious. 25X1

We expect the United States will continue to play an important role in the Guatemalan economy by virtue of its status as that country's largest trade and investment partner. Despite the huge amounts of aid needed to revitalize the economy, US economic and political leverage is unlikely to grow proportionately. Rios Montt's nationalist streak and the strong and growing influence of the military would probably preclude Guatemala from accepting aid with many political or economic strings attached unless the economic deterioration becomes greater than we now foresee. 25X1

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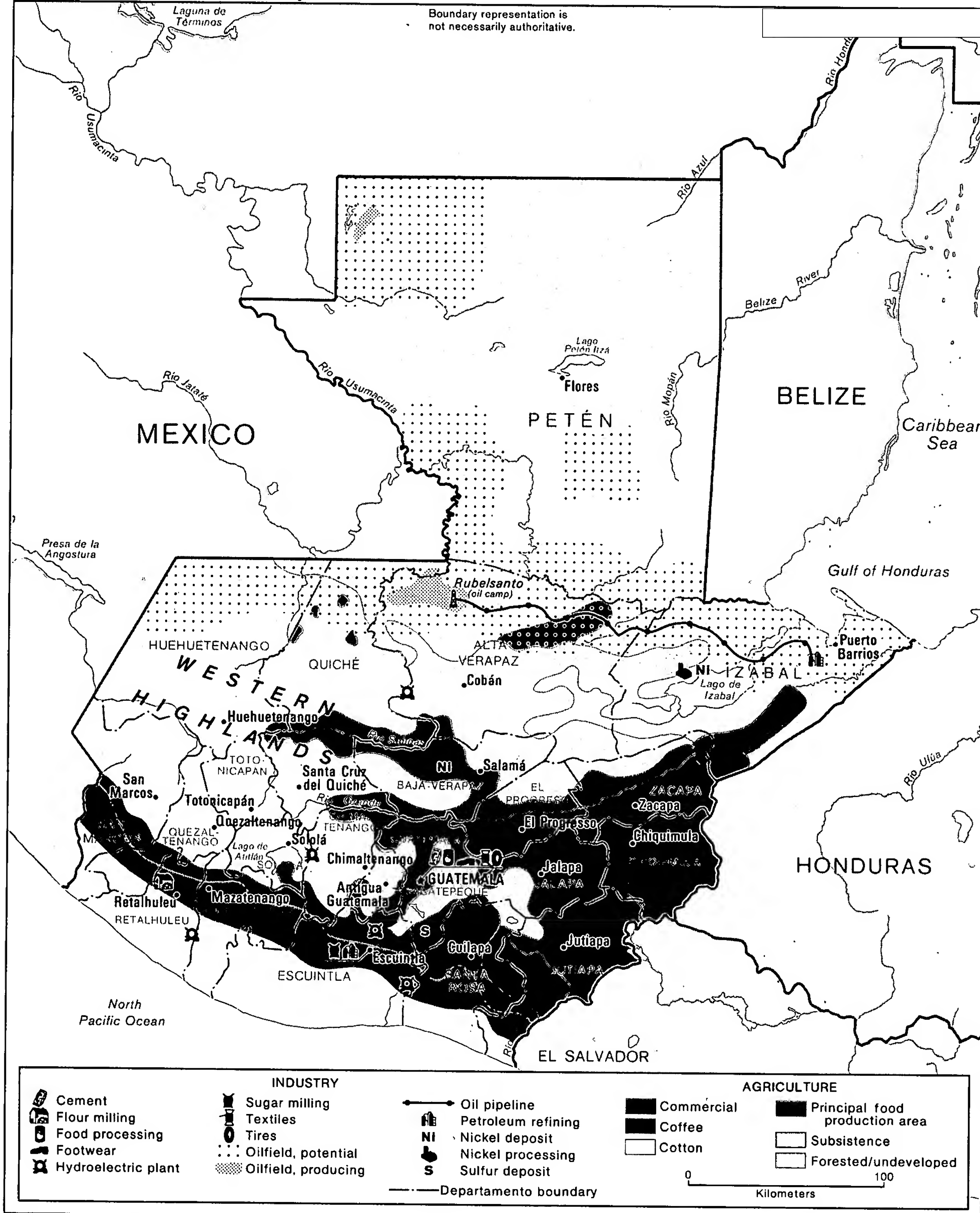

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Guatemala: Struggling To Set a New Economic Course 25X1

Introduction

The economic decline that started last year, the first drop in Guatemala's economic activity in 30 years, has underscored that country's vulnerability to the problems that have long plagued Central America. Several factors, including a persistent domestic insurgency, the world recession, and restrictive government policies are responsible for bringing the region's largest economy to its knees. Since the start of the 1980s, regional and domestic insurgency has virtually dried up foreign commercial credit, decimated the tourist industry, stymied private investment, and encouraged capital flight. Meanwhile, low world prices for Guatemala's agricultural products have caused a dramatic drop in export earnings. The economic deterioration and growing pressures for political and social change, in turn, are causing increased bickering within the oligarchy of industrialists and plantation owners that has long managed the economy practically as its private fiefdom, and are deepening the distrust between it and the military government.

Paradoxically, the economic decline occurs when the Rios Montt regime is making substantial strides in fighting the guerrillas. The government also has begun to lay the groundwork for the political and social reforms that could break the pattern of violence and repression that has characterized Guatemala's turbulent history. Should the economic downturn continue, it would set back—and possibly smother—these promising developments.

In light of the deepening economic crisis and its worrisome implications, this assessment examines the roots of Guatemala's economic problems and reviews recent economic performance. The paper also assesses the foreign financial needs associated with some of the paths Guatemala could take, bearing in mind the domestic and foreign limits on its choices, and evaluates the likelihood of possible outcomes over the next few years.

Gains of the 1970s

Guatemala's economy grew at an impressive real rate of 6 percent annually in the 1970s. While this expansion was little better than the average of the non-OPEC less developed countries (LDCs), it was noteworthy because it entailed little of the runup in external debt that virtually exhausted the creditworthiness of many LDCs. Instead, foreign trade and related private investment—three times the level of public outlays—were the main engines of growth. Unlike many LDCs, Guatemala resisted the buildup of inefficient state-run enterprises, which might have sopped up limited financial resources and expertise. Thus, even with a fairly low 14 percent of GDP going to domestic saving because of meager taxation the business community was able to channel funds into growth-generating investments that helped to maintain the economic momentum. At the same time, conservative fiscal policies moderated inflation, with most price hikes reflecting higher import prices that mirrored inflation rates in the United States. 25X1

As a result, because of these structural differences that set it apart from most LDCs, Guatemala—particularly its private sector—was able to mobilize quickly to withstand jolts to the economy and to take advantage of new opportunities until the end of the decade. Guatemala's quick adjustment to the 1973-74 oil crisis partly reflected a resurgence of trade with other Central American countries as the benefits of the Central American Common Market (CACM) continued to spread throughout the region. A boom in coffee and sugar earnings in response to high world prices, and the tapping of hefty foreign exchange reserves generated by balance-of-payments surpluses in previous years, also facilitated growth. Even the severe earthquake in 1976, which destroyed a large

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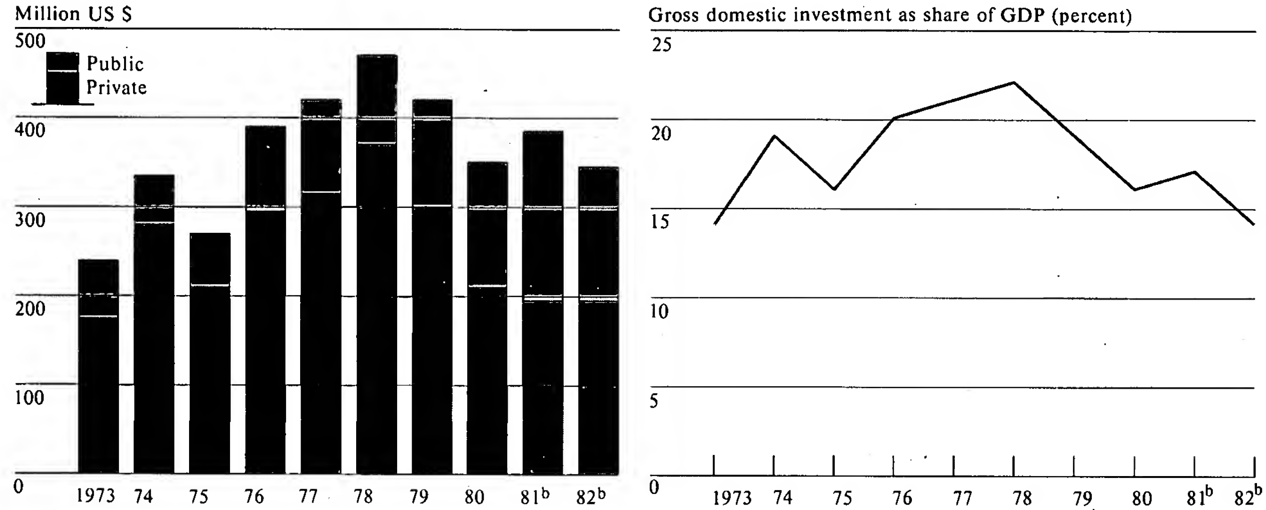
Figure 1
Guatemala: Real Gross Capital Investment[a]



[a] Indexed to 1958 US $.
[b] Estimated.

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share of the country's social infrastructure but spared major export-oriented plantations and other productive assets, failed to interrupt the pace of economic activity. The attendant spurt in demand for building materials and replacement consumer durables was easily covered by an infusion of foreign aid—including donations of $120 million—and record coffee earnings that helped to underwrite extensive governmental credit programs. (See appendix A.)

When the second major oil price hikes came in 1979, however, the economy was caught off guard. Oil production, which had begun in 1976, still met only 5 percent of domestic consumption in 1979; this was not enough to soften the impact of skyrocketing import costs. Meanwhile, coffee prices declined sharply following the boom years of 1976-77, and low world prices dampened earnings from other export crops. Manufacturing sales—nearly all of Guatemala's industrial exports are sold to CACM members—began to limp as regional turmoil and low commodity prices hit this market. For the first time in five years, Guatemala drew down its international reserves but, nonetheless, retained comfortable holdings equivalent to six months' import cover. At the same time, adverse international publicity and a rise in terrorism curbed foreign and domestic investment. Real economic growth of 4.7 percent for 1979 as a whole masked a serious slowdown in the second half of the year. 25X1

Slackening Growth in 1980-81 25X1

By the start of the 1980s, declining world agricultural prices, regional strife, and domestic political tensions had begun to undermine economic activity across the board. All of Guatemala's CACM trading partners curtailed imports, squeezing the Guatemalan manufacturing sector in the process. Although government spending rose as implementation of large projects under the 1979-82 development plan slowly took hold, government revenues, limited by the small tax base and the economic slowdown, did not keep pace; as a result, the budget deficit soared to a record 7.4 percent of GDP in 1981. Rather than revert to

Table 1
Guatemala: Selected Socioeconomic Indicators

	Guatemala	Average for Central America	Average for LDCs
Adult literacy *(percent)*	46	71	48
Urbanization, 1980 *(percent)*	39	44	32
Life expectancy at birth, 1980 *(years)*	59	63	58
Population growth rate, 1970-80 *(average annual percent)*	3.0	2.8	2.4
Per capita income, 1981 *(US $)*	1,080	1,060	890
Labor force in agriculture, 1980 *(percent)*	55	44	54

[redacted]

expansionary monetary policies, Guatemala City dipped heavily into the local money market to cover growing deficits. The government, however, lowered legal commercial bank reserve requirements to prevent a substantial squeeze on credit availability for the private sector. [redacted]

Even with the government struggling to play a more stimulative role in the economy, growth slowed to 3.5 percent in 1980 and to 1 percent in 1981. Agriculture was particularly hard hit, expanding only 1.8 percent in real terms in 1980 and 1 percent in 1981. Low world commodity prices, reduced credit availability to the private sector at home and from abroad, and escalating terrorism placed a heavy burden on commercial agriculture, as did the "war taxes" some plantation owners paid the guerrillas to ward off theft and property destruction. Outside of commercial agriculture, the production of corn, beans, and other staples stagnated. Although Guatemala City raised support prices in 1981, this incentive came too late to increase that year's crop. Only Salvadoran and Nicaraguan purchases to rebuild their economies and the drawdown of inventories allowed Guatemalan manufactures to maintain some growth. Construction lagged as the start of several major public investment projects failed to offset the deepening recession in the private sector. [redacted]

Guatemala's balance-of-payments situation also worsened noticeably. Although nominal export earnings surged 25 percent in 1980 because of the rise of industrial sales to neighboring countries, a number of factors weighed more heavily in 1981 to weaken Guatemala's trade position. The continuing drop in world commodity prices triggered tight export quotas on coffee and sugar under international agreements. The suspension of nickel operations since September 1980 because of rising petroleum costs and the falling price of nickel was another blow. Although Guatemala began exporting crude oil in 1980, the increase in export revenues barely began to cover the steep costs of imported crude and petroleum products. Tourist earnings shrank from a peak of $82 million in 1979 to $30 million in 1981. Even though the value of imports grew only moderately in 1980 and fell in 1981, there was no substantial relief from this factor. [redacted]

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The worsening payments difficulties necessitated new financial approaches. On top of plummeting investment inflows, foreign commercial credit virtually dried up after August 1981. Capital flight became more worrisome as investors chased higher interest rates and a safer haven for their money abroad. As a result, Guatemala for the first time since 1973 imposed foreign exchange controls in 1980 to stem the capital drain. [redacted]

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More important, Guatemala took its first tentative steps toward more comprehensive economic management to qualify for a $112 million IMF standby and compensatory financing package. After months of haggling, Guatemala in late 1981 secured the one-year IMF program only after the government raised domestic interest rates to stem the private capital outflow and pledged to reduce domestic financing in favor of foreign funding of the projected 1982 budget deficit. Still, its foot-dragging on setting priorities and reorienting imports and in pursuing foreign funds meant that Guatemala had to draw down its foreign reserve holdings from $718 million in 1979 to $172 million—equivalent to nearly six weeks' import cover—in 1981. [redacted]

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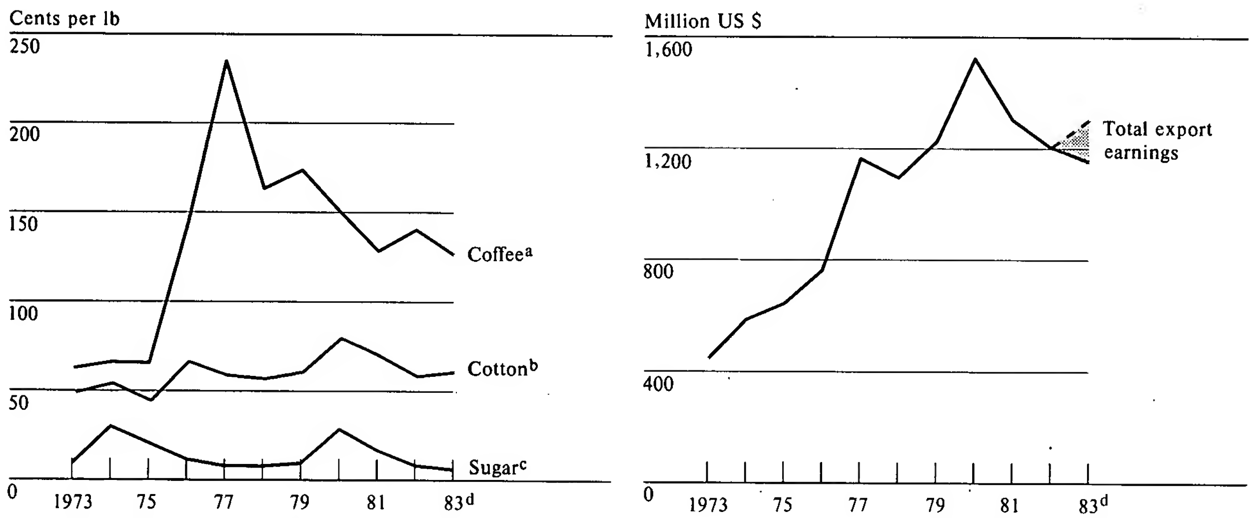
Figure 2
Guatemala: Key Commodity Prices



a Other milds-Arabicas, ex-dock NY, cents per lb.
b Memphis middling 1 1/16 inch, cents per lb.
c World raw London, bulk, cents per lb.

d Commodity prices represent an average for the first quarter; total export earnings are projected for the entire year.

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The Recession Takes Hold in 1982

The Rios Montt government installed following the coup on 23 March 1982 moved quickly to reverse the insurgents' momentum, improve Guatemala's international image, and restructure the political system:

- Employing a fresh tactic of "Beans and Bullets" to undermine the insurgency and increase the loyalty of the peasants, President Efrain Rios Montt used the Army to give peasants supplies of food, medicine, and building materials, much of which came from international relief organizations.

- In line with this strategy, the government redirected its development program away from large-scale projects to smaller undertakings to strengthen the economic and social infrastructure in the impoverished highlands.

- The formation of peasant civilian defense forces strengthened popular support of the government, even though the groups were poorly armed.

- At the same time, Rios Montt implemented a campaign against political corruption and human rights abuses; former government officials were arrested, the police reorganized and civilians disarmed. Soon after the coup, the new government temporarily suspended government payment orders and canceled a huge highway project to uncover graft among former officials.

By the end of 1982, the Army had reestablished authority over much of the population and territory that had been under insurgent control, and had regained the loyalty of some Indians who had previously aided the guerrillas.

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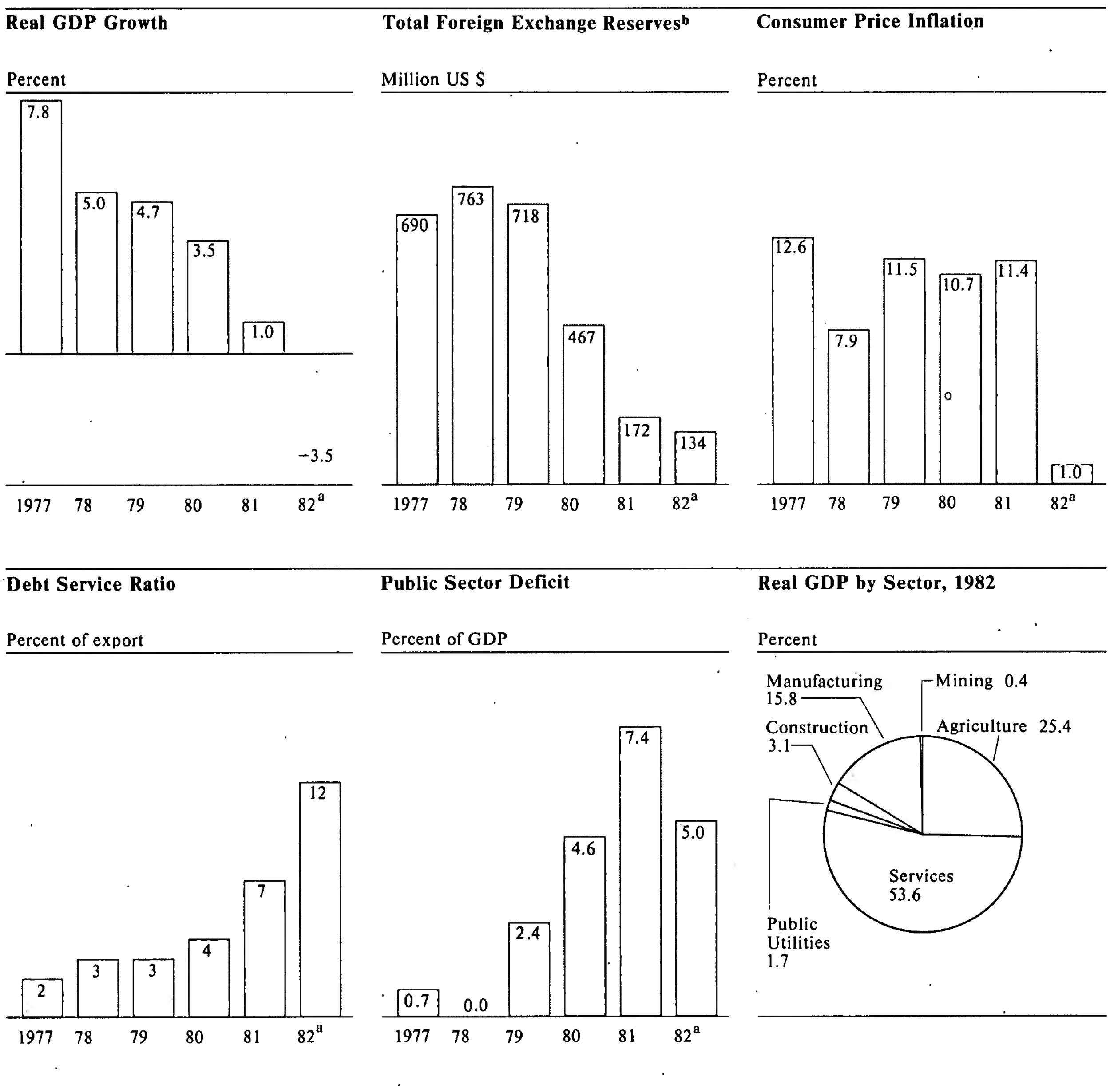
Beyond these initial steps, however, the new government's focus on military and political priorities diverted its attention from the hard economic decisionmaking needed to avert a further weakening of the

Figure 3
Guatemala: Economic Indicators



[a] Estimated.
[b] Excludes short-term entries.

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Table 2
Guatemala: Western Official Development Assistance, 1977-81

Million US $ disbursed

	Total 1977-81	1977	1978	1979	1980	1981
Total	**631.5**	**121.1**	**110.9**	**119.3**	**157.0**	**123.2**
Bilateral	248.1	57.7	38.8	38.3	78.9	34.4
United States	105.0	27.0	20.0	20.0	18.0	20.0
France	54.3		5.6	3.8	44.6	0.3
Canada	30.3	21.0	4.0	2.3	1.7	1.3
West Germany	28.5	3.4	4.2	6.3	7.8	6.8
Japan	11.1	2.2	2.2	2.0	2.7	2.0
Other	18.9	4.1	2.8	3.9	4.1	4.0
Multilateral	383.4	63.4	72.1	81.0	78.1	88.8

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economy.[1] While laying the basis for a long-term economic recovery, the counterinsurgency drive—and falling revenues—further strained government finances; this in turn prompted the regime to slash capital spending over 20 percent below the 1981 level.

A fortunate side effect of the recession—and one that removed a serious problem for decisionmakers—was that it eliminated demand pressure for inflation. Although the government dipped heavily into local money markets to finance the remaining deficit, the sharp slowdown in private-sector activity prevented a liquidity crunch and kept average price increases to 1 percent.

The effects of this turmoil on the economy were readily evident. Output contracted by 3.5 percent last year—the first drop in economic activity in several decades. Construction was hardest hit, falling 18 percent as the revenue shortfalls necessitated deep cuts in development projects. Real agricultural output fell 2 percent; rising production of food staples in response to higher producer prices only partly offset the 10-percent drop in commercial farming that resulted from low world demand and insurgency-induced disruptions. With import controls hitting manufacturers especially hard—foreign purchases of inputs fell 20 percent—only a rapid drawdown of inventories kept the 5-percent decline in manufacturing output from being even steeper. Moreover, the number of bankruptcies soared. Buoyed by rising oil sales, only the mining sector sustained rapid growth—over 12 percent 25X1

We believe Guatemalan official statistics, which report that the unemployment rate grew slightly to 11 percent, underestimated the jobless rate by 10 or so percentage points and masked severe and growing underemployment.[2] Seasonal agricultural jobs were hit especially hard. According to US Embassy reporting, the government's counterinsurgency effort in the highlands obstructed the movement of migratory workers to the plantations on the south coast even as the guerrillas damaged agricultural production there. Although the regime implemented a "food-for-work" program, budget constraints soon limited the size of this project. 25X1

Only the sharp cut in imports and a buildup in foreign exchange arrears kept Guatemala's foreign financial needs to a manageable $520 million. Nominal imports

[1] For details on the economic views of key governmental and private-sector leaders, see appendix B.

[2] Consistent and reliable unemployment data for Guatemala are unavailable. In early 1982 the US Agency for International Development, using a simple macroeconomic model and assuming real GDP growth of 4 percent, estimated that Guatemala's unemployment rate would reach 15 percent last year. We adjusted this estimate to reflect the economic decline that set in during the year.

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Table 3
Guatemala: Foreign Financing Gap

Million US $

	1979	1980	1981	1982 [a]	1983 [b] (Case I)		1984 [b] (Case I)	
					Best Conditions [c]	Worst Conditions [d]	Best Conditions [e]	Worst Conditions [f]
Current account balance	−206	−163	−566	−371	−350	−120	−470	−160
Trade balance	−290	−78	−246	−200	−250	−20	−370	−60
Exports, f.o.b.	1,221	1,520	1,299	1,200	1,205	1,100	1,220	1,115
Petroleum	0	24	22	46	36	36	40	40
Coffee	432	464	325	375	378	375	378	375
Cotton	188	165	170	95	120	100	120	100
Sugar	54	69	85	44	90	40	90	40
Bananas	18	45	50	71	21	20	26	25
Other	529	753	647	569	560	529	566	535
Imports, c.i.f.	1,511	1,598	1,545	1,400	1,455	1,120	1,590	1,175
Petroleum	242	344	378	303	230	230	230	230
Net services and transfers	84	−85	−320	−171	−100	−100	−100	−100
Interest, including IMF charges	−72	−96	−100	−74	−55	−55	−55	−54
Amortization	59	98	109	150	90	90	105	105
Financial Gap	−265	−261	−675	−521	−440	−210	−575	−265
Direct investment (net)	117	111	127	76				
Medium- and long-term loans	200	234	398	410				
Net short-term capital and errors and omissions	−81	−330	−154	24				
Change in reserves	−29	−246	−304	−11				

[a] Estimated.
[b] For details on the scenarios and the methodology underlying our projections, see appendix C.
[c] Projected, assuming 3-percent growth and moderate rise in world commodity prices.
[d] Projected, assuming 4-percent economic decline and continuing low world commodity prices.
[e] Projected, assuming 3-percent growth in 1983 and 1984 and a moderate rise in commodity prices.
[f] Projected, assuming 4-percent decline in 1983 and flat growth in 1984 and continuing low commodity prices.

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were slashed 9 percent—the lowest level since 1978—by a quota system that began as a deliberate slowdown by the Central Bank in processing paperwork but was institutionalized after the IMF standby agreement expired in November. Nominal exports declined 8 percent below already depressed levels. Tight international quotas continued to restrain coffee and sugar exports, and cotton sales plummeted, largely in response to the sharp drop in world prices and the shortage of imported inputs. Manufacturing sales to the depressed CACM market sagged badly. The only bright spot was petroleum; exports more than

doubled to $46 million in 1982. Continuing bad publicity caused tourist earnings to slide to barely $15 million, half of the low 1981 level.

Even these distressing patterns do not give a complete sense of the confusion and stress—abetted by government mismanagement—that beset the economy.

- The Lucas Garcia regime failed to realize the seriousness of Guatemala's financial plight until a foreign bank consortium refused to roll over a $75 million loan in February 1982. Repayment of the loan virtually wiped out Guatemala's foreign reserves.

- Under Rios Montt's leadership, the Central Bank continued to ration foreign exchange by allowing logjammed applications to relieve pressures temporarily rather than vigorously pursuing foreign funds.

- Although the government drafted a new petroleum law to attract new investors, it has yet to be implemented, partly because of private-sector opposition to the portion stipulating the formation of a national oil company.

- The economic cabinet, drawn almost totally from the private sector, dragged its feet on a new accord with the IMF when the standby agreement expired in November. Fearful that any new accord would entail harsher austerity—especially higher taxes and interest rates—that would undermine support for it within the business community, the Guatemalans waited until after the chief opponent, Central Bank President Gonzalez Del Valle, was fired in late December before inviting an IMF team to discuss a new program. By then, however, the private sector had built up $350 million in arrears to its foreign suppliers as Guatemala tried to protect its remaining international reserves—which had dropped to barely one month's import cover

Prospects Through 1984

Economic performance in 1983-84 will depend primarily on how much control the Guatemalan Government can exert over the insurgency and on the availability of foreign exchange. These critical factors, in turn, will shape business confidence and strongly influence investment and production in the import-dependent agricultural and manufacturing sectors. World prices and demand for agricultural commodities and the level of CACM trade will remain important in determining growth-generating import levels. In addition, we believe the responsiveness of international donors and bankers will weigh more heavily in this regard than previously. 25X1

Recognizing that these factors will drive the near-term outlook and realizing that numerous variants in our findings are possible, we analyzed their impact under three different scenarios for political and military conditions.[3] In measuring Guatemala's foreign financial needs under these scenarios, we projected a lower range growth target assuming economic stagnation and an upper range target of 3 percent, the minimum required to prevent further erosion of per capita income. These targets are unambitious by historical standards but could be no easy feat in the region's changed environment. Moreover, we tempered our analysis by the assumption that Guatemala, never a recipient of large amounts of aid in per capita terms, is not likely to receive a sharp increase in foreign assistance. 25X1

The particular cases examined were:

Case I The Rios Montt government avoids sudden political reversals but cannot do more than keep the insurgency from escalating.
Case II Rios Montt continues to consolidate his position and effectively eliminates the insurgency.
Case III Internal security deteriorates sharply to the point where Rios Montt might effectively lose control or be ousted. 25X1

Common Features. Regardless of which scenario we examined, it was clear that an improvement in the security situation alone would not be enough to improve depressed Guatemalan living standards any time soon. At best, real per capita incomes would

[3] For further description of the sources and methodologies used in developing these cases, as well as a discussion of our data sources for 1981-82, see appendix C. 25X1

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stagnate while the foreign financial gap would widen. Basic limitations stand out in each case that will constrain economic activity during the time frame of this assessment:

- Even if the global economic recovery is stronger than generally expected, the spectacular rise in commodity prices and demand needed to remedy Guatemala's foreign exchange bind is unlikely.

- The regional economy is likely to remain depressed and preclude a resurgence in Guatemala's CACM trade.

- Because businessmen probably will remain chary of sizable investments even if the political and security outlook substantially improves, needed export and market diversification will take considerable time.

- Under the best of circumstances, tourism will be slow to recover from the bad publicity incurred by regional turmoil.

- Worried about regional turmoil and their high Latin American exposure, foreign bankers will be reluctant to increase lending to Guatemala substantially.

- Any steps toward more cohesive economic policies are likely to be limited and to have little immediate economic impact. The new value-added tax, to replace a number of sales and foreign trade taxes, for example, already is in jeopardy because of private-sector complaints and would only improve tax collection and administration over the medium term.

As we reflected on these basic indicators and expected patterns, we were also struck by an important and continuing change in the atmospherics of economic policymaking. Many business leaders increasingly fault the government for neither coming to grips quickly with nor consulting with them on the deteriorating economy and are likely to push harder for direct participation in making economic policy. Government resistance to a currency devaluation and removal of foreign exchange controls, and its half-hearted approach to seeking foreign aid, are increasingly irritating some businessmen. Nonetheless, vociferous opposition from key conservative elements within the business community and the military probably would thwart Rios Montt or any successor from steering the government toward a much more direct role in trying to revitalize the economy or implement social reforms. 25X1

Guatemala City already has slashed the 1983 budget 16 percent below the 1982 level, a factor that could limit its maneuverability on the economy beyond this year. Further retrenchment (despite the growth in the government's role since the mid-1970s, its share of national product barely exceeds 15 percent) could begin to jeopardize planned public investment centered on small-scale projects, such as building feeder roads and creating potable water supplies in the heretofore neglected Indian highlands. Moreover, Guatemala City lacks the administrative and technical skill to design quickly, let alone implement, undertakings that might be associated with any large infusion of new foreign project aid. 25X1

Case I: Violence Remains Near Present Levels. We judge this scenario as the most likely. Fluctuating levels of violence, in our view, will continue to characterize the Guatemalan political scene even if, as we expect, additional reforms under Rios Montt's tutelage further reduce political polarization over the next two years. We believe the government's aggressive military tactics and civic action programs will continue to hold the insurgents at bay but will be unable to eradicate them. The insurgents probably will play it safe and attempt to regroup, limiting their thrust to the sorts of high-visibility, low-risk sabotage that followed government repression of the insurgency in 1968. We believe they cannot afford to do much more 25X1
because their potential sources of outside support are engaged in El Salvador and Nicaragua. As long as insurgencies persist in these two countries, we believe Guatemalan guerrillas can expect only limited help from Cuba, the USSR, and its allies. 25X1

In these circumstances, we judge that foreign and domestic business confidence will be slow to revive, postponing the start of economic recovery until 1984 at the earliest. In the absence of much new private

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investment, an economic upturn would occur only if there is a large infusion of new foreign aid aimed primarily at easing the shortage of imported inputs—industrial raw materials, intermediate goods, agrochemicals, and replacement parts—necessary to take up slack in agriculture and industry. 25X1

Depending on whether world commodity prices remain depressed or reach historically moderate levels, we project that overall exports still will range in a narrow band between $1.1 billion and $1.2 billion—well below the 1980 peak—over the next few years:

- We calculate that agricultural export earnings will range between $675 million and $750 million in 1983 and $680 million and $755 million in 1984. Even barring bad weather, coffee sales probably will merely stagnate; Guatemala should be able to fulfill the tight quota set by the International Coffee Organization (ICO), but reduced investment, spreading coffee rust, and a proposed ICO crackdown will limit sales to non-ICO members. Sugar sales also will be limited by quotas set by the International Sugar Organization; the US quota, pegged higher than the world market price, will provide some relief. Nearly half the banana crop was destroyed by high winds in March. Unless the multinational fruit companies quickly raise the $15 million needed to replant, they may further curtail their operations. Beef production probably will stagnate, but declining domestic consumption could allow a slight increase in exports. Only cotton production could slightly improve if a recent US commercial loan, largely for cotton planters, is disbursed soon.

- Manufactured exports will contract further in response to the shrinking CACM market and import shortages. Even better administration of import quotas and licensing probably would allow only a few producers to conduct business as usual.

- Declining world oil prices will cut Guatemalan petroleum export earnings—according to US Embassy reporting, it would take nearly a decade to find, develop, and bring to market any major new fields—but Guatemala will benefit from the price drop because it will remain a net oil importer during 1983-84.

Moreover, tourism is unlikely to recover enough to make a dent in the foreign exchange shortage. Even with a better promotional campaign, it will take years to repair the bad publicity incurred by regional insurgency. 25X1

At these export levels, we calculate that the foreign financial gap would be in the $440-545 million range in 1983 and the $575-680 million range in 1984, if Guatemala is merely to support the 3-percent annual growth needed to protect per capita incomes and to honor foreign debt service obligations that come due during this period.[4] To achieve this target—which excludes paying off existing foreign exchange arrears—Guatemala would need imports worth about $1.5 billion in 1983 and $1.6 billion in 1984. Alternatively, for the economy just to stabilize in 1983 and to then achieve 3-percent expansion in 1984, foreign financing needs would still be $385-490 million in 1983 and $515-620 million next year. Because Guatemala's external debt is much lower and more concessional than most of its neighbors', the debt service burden—projected at $145 million, or less than 15 percent of merchandise export earnings in 1983—will remain relatively light. 25X1

Although financing requirements of these magnitudes are well within the range covered in the past two years, Guatemala will be hard pressed to secure enough new foreign funds to avert a further decline in economic activity. Having steadily drawn down international reserves over the past three years to the point where they presently can barely cover one month's worth of imports, Guatemala can no longer count on this cushion. 25X1

Although the IMF expects Guatemala to sign a letter of intent soon for a new $125 million standby loan, we believe negotiations could drag on and that in any case an IMF accord would only slightly ease Guatemala's acute foreign exchange shortage. A key feature of the IMF program is the new value-added tax to

[4] This range is based on various assumptions for world commodity prices. See table 4 in appendix C for a summary of the full range of our financial gap analyses covered under Case I. 25X1

improve revenue collection. The preliminary agreement calls on Guatemala to achieve a balance-of-payments equilibrium by the end of the 18-month accord, gradually eliminate the $350-450 million in arrears on foreign obligations, and reduce the fiscal deficit moderately. Despite Guatemalan fears, the IMF did not demand that the government devalue the currency, probably because Guatemalan exports have been crippled more by regional turmoil and low world commodity prices than by an erosion in international competitiveness.

Beyond a US commercial loan of $95 million—expected to be finalized soon after nearly a year of negotiations—and some World Bank financing, we judge that even an IMF accord could not prime much additional foreign financing. Traditional Western donors will probably retain conditionality on human rights performance that would keep such aid unpalatable. Guatemala's access to funds also will be hurt because the IMF imprimatur on most LDCs no longer brings a quick foreign banker response. Worried about the poor security in Guatemala—as well as elsewhere in the region—and their overexposure in Latin America, few foreign commercial banks would be likely to lift quickly their informal freeze on new credit. Similarly, foreign investors, discouraged by foreign exchange restrictions that prevent normal repatriation of profits and other factors, are unlikely to expand their operations significantly. Despite these stringencies, we believe Guatemala's conservative debt management policies will preclude it from seeking any formal rescheduling of its external obligations.

The IMF expects Guatemala to reduce its foreign exchange arrears. Even if we assume no dent is made in the payments backlog, then the country still would need $105-210 million, depending on world agricultural prices, to contain the economic shrinkage to the 4-percent rate compatible with the US Embassy's and our forecast. Timely disbursements from the IMF and other loans now being negotiated would largely fill the upper range of this gap. Assuming the economy then merely stagnates in 1984, the foreign financial gap still would grow to a projected $160 million to $265 million. In these circumstances, we think better administration of import controls that would redistribute consumer imports into growth-generating purchases could allow nominal overseas purchases to fall as much as 20 percent to $1.1 billion in 1983 and barely rise to $1.2 billion in 1984. 25X1

Painful adjustments would be widespread in this scenario. According to the US Embassy, many businessmen are losing confidence in their ability to maintain their operations and are more willing to lay off employees than in the recent past. We believe the unemployment rate could reach 30 percent this year. Urban joblessness will be especially severe, as large- 25X1 scale factory layoffs and the deepening construction slump prompt more workers to look for jobs in the less productive service sectors. Although the government is considering make-work projects to generate about 60,000 jobs over the next four years, we believe budget constraints will severely limit public job creation. In this environment, consumer hardships will grow. Cuts in food imports probably will not hurt much, however, because production of corn, beans, and other staples is likely to expand in response to recent official hikes in producer prices. 25X1

Case II: Insurgents Are Defeated. Even if the government could virtually eliminate the insurgency—highly unlikely considering its difficulties in redressing intractable economic and social ills—at least several years of calm at home, and perhaps regionally, would be required to restore fully the foreign and domestic business confidence that is pivotal to economic recovery. As the climate for business gradually began to improve, the demand for foreign financial support would remain high. Import needs would continue to be large as businessmen began to replace wornout 25X1 stock and replenish inventories of imported inputs drawn down during the recession. Improved security also would encourage farm owners to boost imports of fertilizers and pesticides needed to revitalize commercial agriculture. Because our first scenario already included a shift in the allocation of foreign exchange away from consumer goods to purchases needed by the productive sectors, the government would have little additional maneuvering room to contain the overall rise in imports. 25X1

At the same time, the public sector would probably be in a better financial position to contribute to economic recovery as a result of diminished defense needs and slowly rising tax revenues. A lower public-sector deficit, in turn, could reduce pressure on the domestic funds market and allow private-sector credit to expand faster. [redacted]

Although we would not expect a rapid economic recovery through 1984, certain factors would give Guatemala a headstart over its neighbors. The agricultural and industrial sectors—harder hit by disinvestment and shortages of working capital typical of recession than by insurgent sabotage—could revive stronger and faster than in El Salvador or Nicaragua. In addition, unlike these countries, the Guatemalan economy has not suffered a large exodus of skilled labor. [redacted]

Case III: Insurgents Make Substantial Gains. In this scenario, we examined the potential economic damage that would be inflicted by a substantial escalation in domestic violence. Although the Rios Montt regime's successful counterinsurgency drive and recent political openings have reduced the prospects for sudden political and security shifts in Guatemala, any increase in guerrilla activity aimed at oil exports or the harvest of key crops later this year could be even more disruptive than previously because of the economy's weakening ability to absorb shocks. Moreover, the possibility of this scenario would grow enormously should increased guerrilla successes on the battlefield and/or bickering between rightist and moderate factions in El Salvador result in the toppling of that country's government. We believe the shift in outside support to Guatemalan insurgents and the ensuing governmental preoccupation with fighting the guerrillas would leave few financial or manpower resources to prop up the economy. Most small-scale projects in the highlands, for example, almost certainly would be scrapped. As in El Salvador since 1980, where real GDP has shrunk nearly 10 percent each year, the economy would be on a wartime footing. [redacted]

The loss of remaining business confidence, which could be even more damaging to the economy than the direct damage inflicted by insurgents, would accelerate the flight of capital and technical and managerial talent. In addition, shortages of food and consumer goods would be likely to drive up overall import and aid requirements. In this case Guatemala would require much larger sums of foreign financial assistance than we calculate under Case I to prevent living standards from slipping too badly. [redacted] 25X1

We see no prospect for large amounts of foreign assistance, however, even if the Guatemalans were to pursue aid more vigorously. Moreover, if human rights abuses grew in tandem with an escalation of the insurgency—as has happened in the past—potential donors might again withhold aid. Even at currently projected levels of foreign funding, economic activity would decline much faster than at present. In this case, strict controls on the distribution of available goods would fuel inflation as black marketeering and hoarding became more prevalent. [redacted] 25X1 25X1 25X1

Under these circumstances, Rios Montt's hold on power and even the prospect for the next presidential election—which we believe might be held in 1986—could weaken substantially. Increased guerrilla attacks would be likely to strengthen the position of hardliners in the government, a move that could push Rios Montt to abandon plans for social reform. At the same time, relations between the government and the private sector, an uneasy truce, almost certainly would become more contentious as the economy deteriorates. As dissension among influential groups—inside and outside the government—and insurgent violence grow, a climate conducive to an abrupt, and possibly bloody, change in the government could develop. Possible successors to Rios Montt, excluding an unlikely leftist takeover by the guerrillas, probably would be even further to the right and would be likely to impose a more authoritarian government in Guatemala. [redacted] 25X1

A Longer Term Perspective

We judge that Guatemala will be unable to restore anytime in the 1980s the high growth rates of the 1970s. Guatemala probably cannot count on rapidly expanding foreign markets for its cash crops to meet the country's large foreign exchange needs. Even a modest recovery that could lay the foundation for sustained growth would require the continued success 25X1

Economic Impact of the Insurgency

Insurgent damage to the Guatemalan economy has not reached the levels encountered in neighboring El Salvador because the guerrillas in Guatemala are fewer in number, are less unified, and have not received as much outside support. Our survey of reported insurgent incidents in 1981-82 revealed property damage of some $22 million. This figure, however, seriously understates the economic impact of the insurgency because it excludes lost production owing directly to this damage, investments and production forgone because of intimidation, and the probable numerous unreported incidents. The survey, nonetheless, indicates a substantial decline in insurgency against economic targets after May 1982. [redacted]

The targets of the various guerrilla groups have been large farms and plantations, transportation and power networks, commercial and government buildings, and petroleum installations. Most of the incidents, such as burning buses and building roadblocks, have inflicted little damage to productive assets. Other favorite guerrilla targets have included burning gas stations, bombing electrical substations, and damaging bridges. Many large farms were taken over by guerrillas who then burned vehicles and farm buildings. Damage to the country's only pipeline from the oilfields has not been extensive and has usually been quickly repaired. We believe indirect repercussions have been greater than the direct damage. Publicized guerrilla attacks on hotels and tourist areas, for example, precipitated the plunge in tourist earnings, and guerrilla intimidation tactics persuaded a Guatemalan firm to close its barite mine in the Western Highlands. [redacted]

Any increase in violence would directly impair major exports, particularly agricultural products and petroleum. In addition to the constraints facing agriculture under Cases I and II, deteriorating internal security could be especially detrimental. Depending on where the insurgents struck, they could seriously damage both export and staple crops. Only subsistence crops are grown in the highlands, where most of the guerrilla strongholds are now located. In addition to seizing and destroying these crops, the guerrillas might try to prevent migratory workers from taking seasonal jobs on the plantations along the Pacific coast. This action and the fear of financial loss it would instill in plantation owners would interfere with the planting and harvesting of key export crops. The crops themselves would make easy targets for sabotage. The insurgents, however, would be less likely to attack the principal—and better protected—food-growing areas around Guatemala City and farther east but certainly would demand food and supplies. Petroleum installations would be another prime target. The insurgents also could step up their attacks on the country's only pipeline from the oilfields and expand their operations to include oil rigs, port facilities, or the refinery in Escuintla; these installations would take more time to repair than the pipeline. Oil exploration, already hampered by limited accessibility, might stop altogether should the foreign oil companies become sufficiently intimidated. As in El Salvador, another target for sabotage would be hydroelectric plants—including the Aguacapa project near Escuintla. [redacted] 25X1

25X1

Damage by the guerrillas probably would not be limited to the countryside. Urban terrorism could easily escalate with a variety of targets such as power stations, government buildings, and commercial firms. Unemployment could become the government's biggest economic headache; in neighboring El Salvador the unemployment rate probably exceeds 30 percent, an indication of the enormity of this potential crisis. Soaring unemployment would bring with it increased unrest and, in our view, an upswing in support for the guerrillas. At the same time, the influx of peasant refugees in addition to mounting defense costs would overtax the government's ability to house and feed them. [redacted] 25X1

25X1

US Economic Relations with Guatemala

Over the years, the United States has played an important role in the growth of the Guatemalan economy. The greatest impact, however, has come more from US trade and investment than from the modest levels of US foreign assistance.

Trade
Historically, the US market has been important to the Guatemalan economy and a mainstay for that country's private sector in particular. The United States buys mostly food—chiefly coffee, sugar, and bananas—and all of Guatemala's petroleum exports. In exchange, the United States fills a major share of Guatemala's import needs for a wide range of manufactured goods, such as food products, transport equipment, lubricants, fertilizers, pesticides, and other chemical products, as well as such primary products as wood pulp and textile fibers.

Investment
The United States also is Guatemala's leading source of foreign investment. The US Department of Commerce reported that US direct investment in Guatemala stood at $233 million at the end of 1981. In recent years, a major portion of US and other foreign investment has been aimed at the petroleum industry. 25X1

25X1

Banking
US banks—the single largest source of commercial lending to Guatemala—have contributed 48 percent of all credit from Western bankers. The US exposure in Guatemala at the end of 1982, an insignificant $200 million by world standards, is vital to the Guatemalan economy. 25X1

25X1

of the government in reducing the level of political violence and polarization and in providing more moderate, reform-oriented leadership. We believe these tasks, in turn, will become more difficult as domestic opposition grows in the next few years in response to the expected regrouping of insurgents, the pickup in political and labor union activity associated with recent reforms, and the likely prolongation of the economic recession. Moreover, it will be hard to instill the spirit of cooperation between the government and the private sector that is vitally needed to attract and help manage the large sums of foreign assistance necessary to sustain any social and economic progress, regardless of the state of the insurgency. Because some elements in the military want to push social programs more than business leaders do, frictions between these groups over the pace and substance of social reform are likely to spill over to make overall economic management even more contentious, once again regardless of the state of the insurgency.

Thus, beyond the sheer financial costs and the potential drag of regional turmoil, we doubt that key Guatemalan decisionmakers will seriously tackle the sort of reorientation of the economy that would be the key to Guatemala's prosperity. The World Bank has recommended an economic restructuring—with which we concur—that under the best of circumstances would take years to implement. Having largely tapped the benefits of CACM even before the recession took hold, Guatemala needs to diversify exports and markets. Thus, even if CACM began to recover over the next few years, we doubt it would offer a sufficiently large market—once the initial burst of growth subsided—to undergird much expansion for an economy of Guatemala's size. According to the World Bank, Guatemala also needs to revise its industrial incentives to promote more labor-intensive operations and to reallocate funds from its costly program to expand industry outside Guatemala City into efforts that will improve the worldwide competitiveness of Guatemalan products. 25X1

The World Bank also has made extensive recommendations for increasing and diversifying agricultural production that will at the same time absorb the 25X1
growing numbers of underemployed peasants in the highlands. Reporting from the US Embassy indicates, however, that land reform of the kind implemented in

Table 4
Guatemala: Trade With the United States, 1978-81

	Total	Chemicals and Transport Equipment	Machinery Goods	Manufactured Products	Food Materials, Inedible	Crude Vegetable Oils and Fats	Animal, Fuels, Lubricants	Minerals, and Tobacco	Beverages	Other
Guatemalan exports *(million US $)*										
1978	322.2	1.1	2.1	9.5	284.8	15.4	0	0	6.5	2.8
1979	368.2	0.8	0.6	15.3	326.2	13.7	NEGL	0	6.8	4.8
1980	418.1	1.1	1.9	12.0	347.7	15.2	NEGL	23.7	8.6	7.9
1981	308.5	1.7	0.8	8.6	242.0	16.1	0	22.1	10.7	6.5
US share of total Guatemalan exports *(percent)*										
1978	29.6	1.3	8.8	6.6	47.0	7.5	0.0	0.0	46.4	31.2
1979	29.7	0.8	2.9	8.2	51.6	5.0	19.0	0.0	47.8	26.3
1980	27.5	0.8	6.1	4.3	47.2	5.7	6.3	89.0	47.5	29.5
1981	25.2	1.3	2.4	4.7	40.6	7.4	0.0	83.0	56.7	32.9
Guatemalan imports *(million US $)*										
1978	429.0	73.4	192.8	101.7	35.7	10.8	4.5	7.1	0.5	2.5
1979	480.4	92.0	190.7	115.5	40.9	15.7	7.2	15.7	0.5	2.2
1980	546.9	141.6	160.1	133.9	55.4	23.6	9.9	17.7	0.5	4.2
1981	560.8	144.5	142.4	154.7	63.6	22.5	14.6	11.7	0.5	6.3
US share of total Guatemalan imports *(percent)*										
1978	30.8	27.9	44.7	25.2	41.6	47.8	81.6	4.1	15.1	51.9
1979	32.9	33.7	45.0	26.6	49.2	55.6	85.6	6.5	9.7	33.7
1980	32.7	43.6	44.5	28.7	51.0	54.3	88.4	5.2	7.8	60.3
1981	33.5	46.3	40.4	33.9	60.3	56.5	92.1	3.1	11.9	76.4

25X1

El Salvador would be vigorously opposed by most influential Guatemalans. Although Embassy officials have said that Minister of Agriculture Sandoval—and possibly Rios Montt—would like to expand agrarian reform, objections from Guatemalan landholders probably will prevail indefinitely. In that case, attempts to reduce population pressures in the highlands will probably remain limited to colonization projects in the less populated areas in the north or the jungles of the Peten and will fall far short of producing meaningful results.

Implications for the United States

The United States will continue to play an important role in the Guatemalan economy by virtue of its status as that country's largest trading partner and major supplier of foreign investment. At least one-fourth of Guatemala's total exports—and all of its petroleum sales—are destined for the United States. About one-third of Guatemala's imports come from the United States, with machinery and transport equipment composing the largest category. In a regional context, the future performance of Guatemala's relatively large economy—Guatemala contributes more than one-third of Central American and one-half of CACM (Panama is not a CACM member) output—is bound to affect its neighbors. The sheer size of Guatemala's 25X1

private sector will make the pulse of business confidence there an important determinant in the region's ability to resuscitate business activity. [redacted] 25X1

Although the United States has been Guatemala's largest economic donor, and although that country's aid requirements—over the next few years at least—probably will surpass historical levels, US economic and political leverage would be unlikely to grow proportionately to any aid package offered. As recently as in mid-May, Rios Montt publicly reaffirmed his belief that Guatemala must minimize its dependence on foreign aid even as Council of State President Jorge Serrano had just held discussions in Washington with US and IMF officials about a possible IMF-led financing program. Some of Rios Montt's posturing may have been bluster to ease both IMF and other donor conditionality and internal business opposition. But we believe that Rios Montt's nationalist streak and the strong and growing influence of the military would preclude Guatemala from accepting aid with many political or economic strings attached unless the economic deterioration becomes deeper than we expect through 1984. [redacted] 25X1

Although the critical importance of the security situation has prompted Guatemala to seek US military aid, it probably does not expect much, if any, US assistance. Guatemala's recent rejection of a US offer made last January to supply $6.3 million worth of military spare parts and equipment most clearly demonstrates that country's willingness to "go it alone." The Guatemalans claimed they could not afford the cash-and-carry terms (US military aid has been cut off since 1976) and probably will continue to look elsewhere for military support on more generous terms. [redacted] 25X1

Appendix A

Guatemala's Unbalanced Growth

Guatemala—with the region's largest economy—probably has done less with the fruits of its relative size and impressive economic growth in the 1960s and 1970s to improve the lot of its nearly 8 million people than any other Central American country. For generations, the economic oligarchy of plantation owners and industrialists have resisted even the few government initiatives that were made to redistribute income and land and to decentralize industry. In rural areas—where almost two-thirds of the population live—living conditions are especially bad. As a result, life expectancy is only 59 years, little better than that in Honduras, the worst country in the region. Adequate sanitation, potable water, and proper shelter barely exist outside the cities. Moreover, fewer than 50 percent of the country's adult population is literate; this is the worst educational record in Central America.

Guatemala has the region's biggest industrial base, twice the size of second-ranking El Salvador, and more than one-third of the area's population, but it remains highly vulnerable to external shocks. Having largely tapped the limited domestic market, the relatively capital-intensive manufacturing sector—consisting largely of food and beverage processing, textile, and clothing plants—became increasingly export-oriented after the establishment of the Central America Common Market (CACM) in 1960. Its comparative advantage in size allowed Guatemalan industry, and much of the commercial farming sector upon which it is based, to gain inordinately from CACM benefits. These included the creation of a Colombia-size market allowing free regional trade in nonagricultural goods behind a common external tariff. Despite its dynamism, Guatemala's light industrial sector remained largely clustered in and around Guatemala City and Quezaltenango. Moreover, the concomitant surge in commercial agriculture meant that Guatemala at the start of the 1980s was nearly as dependent for foreign exchange on the vagaries of the world market for coffee, cotton, and sugar as it had been two decades before. Still, because Guatemala could fulfill some of its demand for industrial goods locally, it was relatively less dependent on imports than its neighbors; imports accounted for only 22 percent of Guatemala's GDP compared with a high of 41 percent in Honduras. 25X1

Even less than in most LDCs, the tiny public sector in Guatemala has done little to smooth the effects of crop and foreign business cycles. Despite the growing revenue potential that came with soaring incomes of the business elites and booming foreign trade, Guatemalan officials deliberately chose to minimize the self-stabilizing effects of various tax and social insurance programs and the leverage of public spending. The shortage of skilled administrators has long caused large shortfalls in meeting even modest development targets. Unwilling to submit to conditionalities on 25X1
foreign aid and borrowing or to expand the government's role, Guatemala has relied much less than most LDCs on these financial sources to promote economic progress. 25X1

Although the Lucas Garcia government in the late 1970s began to deviate from this pattern by pursuing a somewhat larger role in the economy, its efforts were quickly handicapped. Having become more adept at managing aid inflows following the 1976 earthquake—and, in the view of the US Embassy, more experienced in pocketing foreign aid for personal use—the Lucas Garcia regime launched a four-year development plan (1979-82). The ambitious plan stressed the improvement of social services and costly showcase projects in hydroelectric power, port improvement, and highways that aimed at spreading development outside Guatemala City but also offered greater opportunities for graft and corruption. Guerrilla advances and the worsening foreign exchange bind, however, substantially delayed project completions. Thus, even with these openings, official development aid on a per capita basis to Guatemala remains among the lowest in Latin America. 25X1

Limited employment opportunities in the cities and cultural factors, nonetheless, have checked the sort of rural exodus that has strained public services in many LDCs and, until recently, kept Guatemala's unemployment rate hovering just below 15 percent. Despite its fairly large industrial base, Guatemala's level of urbanization is only 40 percent—the lowest in the region after that of Honduras. Over half of the rural population is Indian and lives in the highlands to the north and northwest of the capital. This population has grown beyond what the land can support; an estimated 9 out of 10 peasants live off plots of land too small to meet even basic needs. As a result, more than 500,000 migratory workers annually descend from the highlands to work on the commercial plantations along the Pacific south coast. Other sectors of the economy have not provided many jobs. For example, capital-intensive oil production in the Peten began commercially only in 1976. Although tourism is labor-intensive and has stimulated some urban employment in construction and hotel-related services and rural jobs centered on Indian handicrafts, this sector remains too small to absorb many workers [redacted] 25X1

25X1

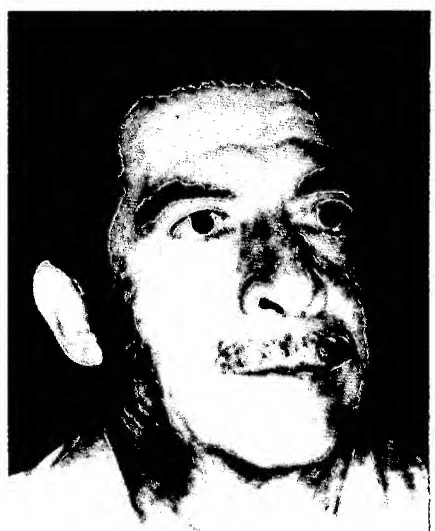
Appendix B

Key Economic Players

The Economic Cabinet

The key economic policy makers in the Guatemalan Government generally are conservative and pragmatic. Since the coup of March 1982 that brought most of them into the government, these Cabinet officials have made few changes in Guatemala's economic policies. Reporting by the US Embassy indicates that most government economists advocate fiscal restraint, favor a free enterprise system, and seem to oppose broad agrarian reform, which to many of them means the "Salvadorization" of land ownership and destruction of the fabric of society. Of all his economic advisers, US diplomats believe that President Efrain Rios Montt probably listens most to Finance Minister Leonardo Figueroa, who is knowledgeable and usually respected by his peers. Figueroa is a former military officer, but this does not seem to hinder his relations with his economic colleagues. Rios Montt selected some members of his economic team from lists of candidates that he requested from the private sector. We believe that his main goal was obtaining competent economic administrators, but that he also was trying to defuse the antagonism and mutual distrust that has built up over the years between prominent businessmen and the government. [redacted] 25X1

(Jose) Efrain RIOS MONTT
President (since March 1982)


UPI ©

25X1

A career military man, Gen. Efrain Rios Montt has little knowledge about economic matters, according to US Embassy officials. He contributes little to the formulation of economic policies, although after he gets the concurrence of military power brokers, he probably makes the final decision on specific policies or programs. The US Embassy reports that his influence on economic policy has been most evident through his shaping of the political process. Indeed, the President's populism, mistrust of big business, disdain toward foreign assistance, and concern for the dignity of the poor in Guatemala could determine, in large part, the country's economic policies. US diplomats believe that Rios Montt might like to implement an ambitious land reform program, but he will not do so at this time because Guatemala's landowners would object. In September 1982 he donated some of his own land to the state for distribution to the people who work it. He said "I am not a farmer, and I invite those who own plots of land that they are not working to return them to the state." [redacted]

Rios Montt says that he believes in a free enterprise system with little government interference, but he has stated publicly that in Guatemala the system has been abused and the government must intervene in the economy until all can benefit from the country's development. A born-again Christian, Rios Montt often punctuates his economic remarks with lectures on morality. For example, during one of his weekly sermonettes in February 1983, he said that "the less the state intervenes in the development of the national economy, the better . . . . However, in a time of crisis, when the welfare of the majority has to be taken into consideration, state intervention is not only a good idea but becomes an obligation for the ruler." In a November 1982 address to Guatemalan business leaders, he urged them to join a national campaign of "justice and might" under three basic principles—"do not lie, do not steal, and do not abuse authority." Strongly nationalistic, Rios Montt would like to see Guatemala rely more on its own resources, but he does seek some foreign assistance. The President is friendly toward the United States. Rios Montt joined the Army in 1943 and in 1950 received a degree in science and literature from Guatemala's military academy. He is 57. [redacted] 25X1

La Tribuna ©

Leonardo FIGUEROA Villate
Minister of Finance (since March 1982)

A former military man who has a background in economics, Col. (Ret.) Leonardo Figueroa was president of the Guatemalan Army Bank before he joined the Cabinet, and he is extremely knowledgeable about the financial affairs of the military. He has impressed US Embassy officials, who have said that he grasps the seriousness of Guatemala's fiscal problems and is acting to resolve them. They report that Figueroa has accomplished sizable cuts in the fiscal deficit by reducing public spending. He has done this, in part, by identifying fraud and mismanagement that resulted in scrapping some large public works projects inherited from the previous regime. Figueroa also apparently has been instrumental in drawing up the tax reform and steep budget cuts that he hopes will be sufficient to qualify Guatemala for an IMF standby program soon. Figueroa has studied in Spain and Italy, and he has a doctorate in economics. He began his career as a line military officer and once served as an artillery commander. Figueroa, who is about 50, is close to Rios Montt, according to US Embassy officials.

Prensa Libre ©

Leopoldo SANDOVAL Villela
Minister of Agriculture (since July 1982)

A specialist in agrarian reform, Leopoldo Sandoval is one of the more liberal members of the Cabinet and would perhaps like to see a land reform program implemented in Guatemala, according to US Embassy officials. Influential landowners—who, US Embassy officials say, already view Sandoval as a socialist or even an extremist—would vehemently oppose any agrarian reform. Although we believe he may privately want to implement an ambitious land reform program, Sandoval has publicly stated that he opposes the breaking up of productive private landholdings and turning them into small peasant-owned plots; he considers such activities politically motivated and potentially destructive to agricultural production. He would like to see both state-owned land colonized by peasants and land that owners either cannot pay for or have abandoned sold to farmers. He has mentioned the need for a holistic approach, preferably cooperatives: agricultural enterprises must combine all factors of production—land, capital, labor—and should be an association between landowners and peasants, with the latter holding income-producing shares in the ventures. USAID officers in Guatemala consider Sandoval to be articulate and well trained, and he, in turn, has sought AID's assistance in establishing a mechanism for a land bank approach to land reform. Sandoval, an agricultural engineer, has studied in Guatemala, France, Israel, Costa Rica, Mexico, Ecuador, and at the University of California. He spent most of the 12 years before his Cabinet appointment in Costa Rica, where he worked at the OAS Inter-American Institute of Agricultural Sciences. He is 52.

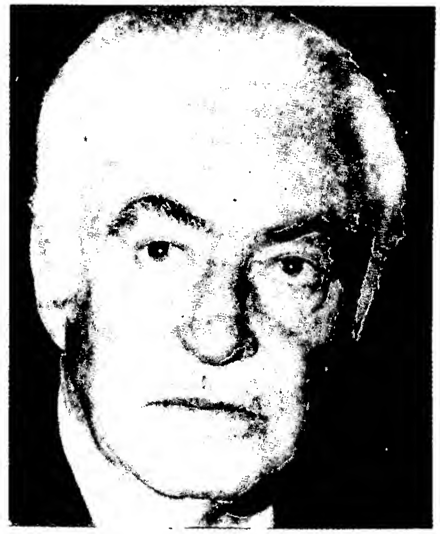
25X1

25X1

La Prensa Grafica ©

Armando GONZALEZ Campo
President, Central Bank (since December 1982)

US Embassy officials in Guatemala report that financier Armando Gonzalez was appointed mainly because he had served since April 1982 as a vice president of the Central Bank. Although he was the Guatemalan director of the Central American Monetary Council (with headquarters in Costa Rica) in the early 1970s, he is not as well known in international financial circles as his predecessor. Nonetheless, according to US Embassy officials, he is competent, knowledgeable, honest, and shows flexibility in dealing with people. He follows current government economic policy and has opposed devaluation of the currency. Gonzalez supervises management of foreign exchange allocation, although we are uncertain what contribution he makes to overall policy regarding the exchange rate. He has worked hard to acquire a standby agreement with the IMF, including leading a delegation to Washington in mid-April 1983 for negotiations with Fund officials. Gonzalez has a degree in economics from San Carlos University. He previously was an official of the Central Bank during the late 1960s and early 1970s. According to US economic officials stationed in Guatemala in the 1970s, he played an important role in the preparation of the country's first five-year plan. As Central Bank president, Gonzalez, who is in his fifties, is subordinate to Finance Minister Figueroa 25X1



Diario de Centro America ©

Otto PALMA Figueroa
Minister of Labor (since March 1982)

US Embassy officials report that Otto Palma, 60, was appointed to the Cabinet after officials of San Carlos University recommended him for the job because of his expertise in labor law and his service as a longtime adviser to the university on labor matters. Palma, however, has not been popular with Guatemalan labor leaders, who look upon him as a figurehead. The Guatemalans believe that real power in labor affairs is wielded by Col. Zoel Emilio Estrada—President Rios Montt's personal adviser on labor matters—and some of them would like to see the colonel assume the labor portfolio. US Embassy officials report that Palma has done little beyond considering the possible implementation of a cluster of government-sponsored employment projects designed to generate additional jobs. He is, nevertheless, cooperative with US officials, and visiting US labor representatives have been impressed with his ability to delineate the needs of labor in Guatemala. 25X1


Diario de las Americas ©

Edgar Leonel ORTEGA Rivas
Minister of Communications and Public Works (since June 1982)

Col. Edgar Leonel Ortega, 39, was Deputy Minister of Communications and Public Works before his promotion in June 1982. In an April 1983 conversation with US Embassy officials, a high-level member of the Guatemalan Government, who generally criticized the performance of Cabinet members, called Ortega one of the few effective ministers. He recently assumed responsibility for transportation from the Economy Ministry, which US diplomats in Guatemala consider to be an indication of his increasing status in the Cabinet. Ortega, a graduate of the Guatemalan Military Academy, studied civil engineering at the National Autonomous University of Mexico.

The Private Sector's Role

Although the private business sector in Guatemala has traditionally served as a key source of ideas and candidates for the government, it increasingly finds itself in a largely adversary role regarding economic affairs. The private sector, however, does not speak with one voice. US Embassy officials report that it includes such diverse interests—new industrialists, commercial farmers, managers, and other businessmen in the past two decades—that consensus is rare. Instead, a complex coalition of wealthy industrialists and plantation owners forms shifting alliances with conservative military officers on particular issues. 25X1

Although the government does not utilize formal mechanisms to consult with the private sector, it periodically seeks advice from business leaders. Many in the private sector are even more conservative than those who make government economic policy; some of them vehemently believe that only a free enterprise system—free from all unnecessary restraints—will cure the country's economic problems. The most prominent organization through which the business community speaks to the government is CACIF, a group of 14 business organizations (chambers) that represent agriculture, commerce, industry, and finance in Guatemala. Ronald Dent, the president of the Guatemalan Chamber of Commerce, currently serves as CACIF president. 25X1

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Ronald A. DENT Weissenberg
President, Chamber of Commerce (since March 1982)

As president of both the Chamber of Commerce and CACIF, Ronald Dent is the unofficial spokesman for the private sector. He has opposed government economic policies and leaders alike. Dent recently has led private-sector opposition to the tax reforms that Finance Minister Figueroa would like to see enacted. He nearly broke up a meeting with government officials on 19 May by accusing them of intransigence and acting in bad faith, a charge he based on Figueroa's refusal to permit business to review a draft of the tax reform proposals. Dent and like-minded business associates favor at least some devaluation of the quetzal and the dismantling of cumbersome foreign exchange regulations — actions that most economists in the government oppose. He publicly proposed in February 1983 that Guatemala's international monetary reserves be removed from government control, saying, "since the state generates no reserves, it has no right to monopolize them." US Embassy officials consider Dent, who is in his midthirties, intelligent and competent.

Manuel Francisco AYAU Cordon
Rector, Francisco Marroquin University (since 1972)

An engaging spokesman for extreme rightist economic views, Manuel Ayau has lobbied twice in the past year for the job of Central Bank president, but Rios Montt passed him over. US Embassy officials believe that he will probably remain on the sidelines while Rios Montt holds office. They refer to him as a known quantity who is in general disagreement with the economic policies of the government. Involved in many business ventures, he has made a fortune, especially in the manufacture and retail sales of various industrial gas products. A strong believer in self-reliance and the free enterprise system, Ayau prefers the removal of all controls on business operations. In a letter that appeared in the *Wall Street Journal* in April 1983, Ayau even criticized the government's attempt to get an IMF loan. He said that the loan would merely be a temporary bailout, and in the long term would only reduce the country's creditworthiness by increasing its foreign debt. He also complained about government policies, particularly the government's continued resistance to devaluation and its control of foreign exchange, which he maintains make capital investment in export products unprofitable. Educated in the United States and Canada, Ayau, 57, holds a mechanical engineering degree from Louisiana State University.

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Appendix C

Methodological Notes on Economic Forecasts

Economic estimates for 1981-82 and projections for 1983-85 were based primarily on our analysis of official Guatemalan data supplied to the International Monetary Fund and World Bank and on reporting by US and OECD official sources. We also drew on open-source information to establish world commodity prices and historical import price deflators:

- *Foreign Aid.* Official data as reported by donors, particularly OECD members, are our main source of information on foreign aid flows. Estimates, extrapolating past trends and utilizing US Embassy reporting, especially from donor countries, were used to fill the gaps.

- *Foreign Trade.* Estimates for 1982 were based on official Guatemalan data as reported by the US Embassy and the US Agency for International Development and were used to derive 1983-84 projections.

- *Foreign Debt.* Estimates and projections of debt service payments, with which we concur, were obtained from the US Department of Treasury.

- *Agricultural Production.* Our estimates were based on reporting from the US Departments of State and Agriculture.

Our projections for foreign aid requirements for 1983-84 were calculated as the financing needed to close a projected foreign financial gap associated with a particular track for economic growth. This financial gap was calculated as:

$$FG = (I - E) - ST + A$$

where FG equals financial gap, I equals import expenditures, E equals export earnings, ST equals net services and transfers, and A equals amortization of medium- and long-term debt.

Exports were calculated as the product of projected volume and international commodities prices. Volume in 1983-84 was projected to stagnate for coffee and petroleum. We assumed Guatemala would fill its export quota under the International Coffee Organization (ICO) but would be unable to increase sales to non-ICO countries. We foresee little, if any, growth in oil revenues because of the prospect of minimal new investment and the world price outlook. We project a 5-percent increase in cotton exports in 1983 in response to improved credit availability but no rise in 1984 because of continued low world demand. Export volume for sugar was forecast to decline 10 percent in 1983 and level off in 1984 because of the response of producers to continued low world prices and nonavailability of credit. According to Embassy reporting, severe wind damage in March destroyed about $50 million worth of bananas in Guatemala. Slow replanting will keep 1984 volume low. Projections of Guatemalan manufactures exports were derived from our judgment that poor economic conditions in CACM will continue through 1984.

Low and moderate farm commodity prices were derived from world market trends since 1980, adjusted for commodity analysts' expectations based on the OECD business cycle and anticipated market developments. Our low and moderate cases projected commodity prices continuing at the 1982 level and at the average annual level during 1980-82, respectively. We also assumed a 25-percent drop in world crude oil prices in 1983, with a leveling off in 1984.

Imports were derived by inflating with OECD export price projections the real imports we calculated as necessary to support our various assumptions about

Table 5
Guatemala: Projected Foreign Financing Gap, by Scenario

Million US $

1983

	−4-Percent GDP Growth		0-Percent GDP Growth		3-Percent GDP Growth	
	Low Commodity Prices	Moderate Commodity Prices	Low Commodity Prices	Moderate Commodity Prices	Low Commodity Prices	Moderate Commodity Prices
Current account	−120	−15	−400	−295	−455	−350
Trade balance	−20	−85	−300	−195	−355	−250
Exports, f.o.b.	1,100	1,205	1,100	1,205	1,100	1,205
Imports, c.i.f.	1,120	1,120	1,400	1,400	1,455	1,455
Net services and transfers	−100	−100	−100	−100	−100	−100
Amortization	−90	−90	90	90	90	90
Financial gap	−210	−105	−490	−385	−545	−440

1984

	0-Percent GDP Growth (Following −4-Percent Growth in 1983)		0-Percent GDP Growth (Following 0-Percent Growth in 1983)		3-Percent GDP Growth (Following 0-Percent Growth in 1983)		3-Percent GDP Growth (Following 3-Percent Growth in 1983)	
	Low Commodity Prices	Moderate Commodity Prices	Low Commodity Prices	Moderate Commodity Prices	Low Commodity Prices	Moderate Commodity Prices	Low Commodity Prices	Moderate Commodity Prices
Current account	−160	−55	−455	−350	−515	−410	−575	−470
Trade balance	−60	45	−355	−250	−415	−310	−475	−370
Exports, f.o.b.	1,115	1,220	1,115	1,220	1,115	1,220	1,115	1,220
Imports, c.i.f.	1,175	1,175	1,470	1,470	1,530	1,530	1,590	1,590
Net services and transfers	−100	−100	−100	−100	−100	−100	−100	−100
Amortization	105	105	105	105	105	105	105	105
Financial gap	−265	−160	−560	−455	−620	−515	−680	−575

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economic activity. Real import aggregates [5] were linked with economic growth using an incremented elasticity formula:

$$\Delta I = 1.3 \Delta GDP$$

In this case, each 1-percentage-point change in real gross domestic product is associated with a 1.3-percentage-point change in real imports. We based our incremental elasticity projection on a comparison of the calculated values for both 1962-70 and 1970-81. These broad time frames were chosen to smooth the wild fluctuations associated with the coffee boom and bust cycles, the surge in imports after the 1976 earthquake, and the sharp increases in world oil prices in 1973-74 and 1979-80. Further adjustments to the ratio were deemed unnecessary in part because there were no significant shifts in the various shares of import categories during the 1970-82 period. Moreover, changes in the government's development program and in the deterioration of capital stock and

[5] This approach is consistent with the limited data showing a disaggregation of imports by commodity or sector.

inventories since then probably have been insufficient to warrant a substantial increase in the ratio. The track of import elasticities for the period 1962-84 (the ratios are derived from constant 1975 US $) is as follows:[6]

	1962-70	1971-81	Projected 1983-84
All goods f.o.b.	1.3149	1.3216	1.3

Real imports calculated with this ratio for economic growth of 0 percent and 3 percent were converted to nominal values based on OECD projections for OECD export price increases (expressed in US dollars). In our scenario predicting economic contraction in 1983, we used an import elasticity of 5.0 based on 1982 data alone because Guatemala until then had not experienced an economic decline in years; import controls last year demonstrated that consumer purchases could be cut substantially, thereby allowing Guatemala to sustain deeper import cuts than would be expected otherwise. For 1983 the OECD predicts no increase in dollar prices, and for the first half of 1984, a 5-percent jump; lacking additional data, we extrapolated this six-month figure to our full-year projections.

Net services and transfers consisted primarily of known and anticipated direct grants, interest obligations on foreign debt, and profit remittances. We included interest payments on public and publicly guaranteed external debt and on nonguaranteed private debt in our calculations.

Scheduled Amortization. The remaining item needed for our 1983-84 financial gap analysis consisted of principal payments on medium- and long-term external debt. We based our estimates and projections of public and publicly guaranteed debt payments and private-sector amortization on lender reporting.

Table 5 summarizes the full range of our financial gap analyses covered under Case I in the main text.

[6] The elasticities presented are ratios of growth in imports to rates of growth in GDP.

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